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Fleishman v. The Queen, 1998 CanLII 251 (TCC)

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Docket: 97-1012-IT-I
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Docket: 97-1012-IT-I

BETWEEN:

MARVIN FLEISHMAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Reasons for Judgment

Mogan, J.T.C.C.

[1] In 1992, the Appellant received $10,000 from Thomas A. Winiker in connection with a promissory note dated December 31, 1990. In 1993, the Appellant received a further $25,000 from Mr. Winiker in connection with the same note. The Appellant claims that these two amounts are payments of principal with respect to a certain loan but the Minister of National Revenue claims that these two amounts are payments of interest with respect to the same loan. The only issue in these appeals under the *Income Tax Act* for 1992 and 1993 is to determine whether the character of the two amounts received by the Appellant was principal or interest or a combination thereof. The Appellant has elected the informal procedure.

[2] The Appellant was the only witness at the hearing. He has known Thomas A. Winiker for more than 35 years going back to the 1960s. Sometime in 1989 or 1990, Mr. Winiker approached the Appellant and asked him for a loan of approximately $500,000. One or more loans were made in the aggregate amount of $525,000 and were evidenced by a promissory note (Exhibit A-1) dated December 31, 1990. That note is an important document and it states:

FOR VALUE RECEIVED, the undersigned hereby promises to pay to the order of RENVIEW ESTATES INC. by his heirs executors or assigns, upon demand a sum or sums not to exceed in total

FIVE HUNDRED AND TWENTY-FIVE THOUSAND DOLLARS, ($525,000) in lawful money of Canada.

This note shall bear interest at the rate of THIRTEEN AND ONE-HALF PERCENT (13½%) per annum in the first year, and shall be adjusted by mutual consent annually if not paid in full by the anniversary date of this agreement and promissory note.

This note is given in evidence of any indebtedness that has arisen from loans made to Thomas A. Winiker by Marvin Fleishman from Renview Estates Inc.

"Thomas A. Winiker"

[3] The Appellant explained that Renview Estates Inc. (hereafter referred to as "Renview") was a corporation owned 50% by the Appellant and 50% by his wife, Katherine Fleishman. The note was the property of Renview. According to the Appellant, Mr. Winiker made monthly payments of only interest on the promissory note throughout most of 1991 but these monthly payments seem to have stopped around the end of 1991. The Appellant and Mr. Winiker were thinking of purchasing a building in Branson, Missouri sometime in the winter of 1991-1992. The Appellant's wife was very much opposed to any further involvement by the Appellant with the business ventures of Mr. Winiker. Accordingly, there was an agreement worked out between the Appellant and his wife in January 1992 under which she purchased the Appellant's one-half interest in Renview.

[4] At that time, the Appellant and his wife agreed that Renview had a value of approximately $960,000 and, therefore, the Appellant's one-half interest in Renview would have had a value of $480,000. In accordance with the agreement between the Appellant and his wife, the Appellant transferred to his wife his one-half interest in Renview and, in exchange, the wife caused Renview to deliver to the Appellant the promissory note from Mr. Winiker in the amount of $525,000. This was done on the assumption that the promissory note had a value equal to the face amount of the note being $525,000. I am satisfied from the Appellant's evidence, however, that Mr. Winiker's ability to repay the note was already in doubt in the early months of 1992. I therefore question whether the note could on a realistic basis have been given a value of $525,000. In any event, it appears from the Appellant's evidence that he and his wife were in agreement that she would be given credit for having caused the company to deliver to him a value of $525,000 on the assignment of the note.

[5] The agreement between the Appellant and his wife was reduced to writing in a "Settlement Agreement" dated July 7, 1992 (Exhibit R-1). The Appellant stated that prior to the assignment of the note from Renview to himself, the monthly interest payments which had been made by Mr. Winiker in 1991 had been paid to and received by Renview. After the assignment of the note by Renview to the Appellant, there were no payments of any kind on the promissory note subject to the two payments of $10,000 and $25,000 which I shall describe below.

[6] The Appellant stated that he met with Mr. Winiker in a restaurant in Toronto sometime in the summer of 1992. At that time, the Appellant was pessimistic about his chances of having the note repaid and so he told Mr. Winiker that if Mr. Winiker would pay to the Appellant $100,000 in cash on account of the principal amount owing on the note, Mr. Winiker could have an indefinite period of deferment in terms of paying the balance of the principal and any interest accruing thereon. The Appellant claims that Mr. Winiker accepted this proposition but there is no evidence in writing of any kind to indicate that such a proposition was made or accepted or that the terms of the promissory note had been amended. Sometime in the latter part of 1992, Mr. Winiker paid to the Appellant the sum of $10,000 because the Appellant was now the assignee of the note from Renview. And later, in 1993, Mr. Winiker paid to the Appellant a further sum of $25,000 as assignee of the note. It is these two amounts which the Minister assumed were payments of interest with respect to the promissory

note (Exhibit A-1) and which the Minister added to the Appellant's reported income for 1992 and 1993, respectively. According to the Appellant, both of these payments were made in cash. By that I mean real cash and not certified cheque or bank money order or any other form of commercial paper. When asked why Mr. Winiker would make such payments in cash, the Appellant just stated that that is the way Mr. Winiker was. Also, the Appellant stated that there was no receipt given for these cash payments and no other paper documenting the fact that two significant amounts of cash had passed from Mr. Winiker to the Appellant.

[7] The Appellant was clear, however, in stating that he transferred these funds directly to Renview which was then a company wholly owned by his wife, and that such amounts were deposited into the bank account of Renview. The Appellant further explained in a somewhat oblique way that these two payments in the aggregate amount of $35,000 were paid to Renview because, if the promissory note were given a face value of $525,000 at the time of its assignment from Renview to the Appellant, then the Appellant's wife would have caused Renview to transfer to him property having value approximately $45,000 greater than the value of his 50% of the shares of Renview which he transferred to her. In other words, the Appellant felt that he owed to his wife approximately $45,000 because she had transferred to him value of approximately $525,000 in the promissory note when he transferred to her value of only $480,000 in the transfer of his 50% of the Renview shares. Therefore, his transfer to Renview of the two cash payments of $10,000 plus $25,000 (plus the transfer of his 50% interest in Renview) was his attempt to pay to his wife or Renview (her company) an amount approximately equal to the face value of the promissory note.

[8] In evidence, there is no document signed by the Appellant and Mr. Winiker or by either one of them which indicates the character of the two cash payments. There is no evidence in writing as to whether those two cash payments were exclusively on account of arrears of interest with respect to the principal amount of the promissory note; or whether those payments were part payment of the principal amount of the promissory note; or whether those payments were in any way a blend of both principal and interest. According to the Appellant, no such evidence in writing exists.

[9] The Appellant claims that Mr. Winiker had accepted his proposal in the summer of 1992 to make an immediate cash payment of $100,000 on account of principal alone, and that the two cash payments of $10,000 and $25,000 were instalments of that $100,000 principal amount. The Minister of National Revenue looks at the principal amount outstanding ($525,000) and the fact that no regular monthly instalments of interest were paid after the beginning of 1992; and the Minister assumes that the cash payments to the Appellant were arrears of interest. I am left to determine from the evidence and from any relevant commercial law whether those two cash payments were principal or interest or a combination of both.

[10] The law on appropriation as between principal and interest has been established for a long time. In *Atlas Acceptance Corporation Ltd. v. Lamm et al,* (1991) 75 Man.R. (2d) 25, Philp J.A. delivered the judgment of the Manitoba Court of Appeal and stated at page 32:

The law on appropriation of payments is clear:

"It is a well settled doctrine that a debtor who owes to his creditor different and distinct accounts, may direct his payments to be applied as he pleases. It is equally well settled that, in the absence of any appropriation made by the debtor, the creditor may apply the money as he thinks fit." Per: Dubuc, J., delivering the judgment of the court in *McArthur v. McMillan,* (1886), Man. L.R. 377.

One hundred and five years later, that remains a succinct and accurate statement of the law.

A similar principle of law is stated in *Chitty on Contracts*, (27d), 1994 at page 1058 (21-054):

Where there is no appropriation by either debtor or creditor in the case of a debt bearing interest, the law will (unless a contrary intention appears) apply the payment to discharge any interest due before applying to the earliest items of principal.

The same statement appears in *Creditor-Debtor Law in Canada*, C.R.B. Dunlop, second edition, 1994 at page 26.

[11] The only relevant evidence on this issue is the promissory note itself (Exhibit A-1) and the uncontradicted testimony of the Appellant who described the proposal which he made to Mr. Winiker in the summer of 1992. That proposal involved the immediate payment of $100,000 on account of principal alone; and the Appellant claims that the two payments of $10,000 and $25,000 are part of that principal amount. On the evidence, there are two actual payments unappropriated by the debtor. I will apply the principle stated above in *Atlas Acceptance*, "in the absence of any appropriation made by the debtor, the creditor may apply the money as he thinks fit". There is no evidence that Mr. Winiker made any appropriation as between principal and interest. The Appellant, as creditor, has clearly applied the two payments to principal. On the uncontradicted evidence of the Appellant, the appeals are allowed.

Signed at Ottawa, Canada, this 26th day of March, 1998.

"M.A. Mogan"

J.T.C.C.